OUTLINE OF TESTIMONY OF COMMISSIONER STEVEN M.H. WALLMAN BEFORE THE SUBCOMMITTEE ON FINANCE AND HAZARDOUS MATERIALS U.S. HOUSE OF REPRESENTATIVES

REGARDING H.R. 1053: "THE COMMON CENTS STOCK PRICING ACT OF 1997"

April 10, 1997

I. Support for the Bill

- Requires SEC to eliminate barriers to and require quoting of equity securities in dollars and cents.

- Enthusiastically support bill because it will (1) enhance competition among markets, (2) result in substantial annual savings to investors, (3) improve efficiency of markets, (4) make markets more understandable to average investors, and (5) maintain competitiveness of U.S. markets in a global marketplace.

- Toronto Stock Exchange experience provides support for bill.

- Decimals vs. minimum tick size: bill promotes competition among the markets but does not specify minimum tick size. The bill allows that to be determined though the markets and competition.

- Commission discretion under bill to craft a flexible implementation schedule.

- Comments are own views; Commission has not yet taken a position on the bill.

II. Description of Current Fraction-Based Trading System

- Exchange minimum increment rules and the limitations of intermarket communications systems (CQS, CTA, and ITS).

- Origins of current one eighth minimum increment and debate about moving to dollars and cents.

- Savings to investors, and prior Commission pronouncements favoring decimals and smaller minimum increments.

III. Understanding the Benefits of Decimalization

- Advantages to moving to decimals per se (eases understanding, eliminates software conversion costs, facilitates a narrower minimum tick).

- Advantages of a smaller minimum tick include (1) investor savings when trading with professionals ($1.5 billion per year for each penny improvement in the bid or asked amount), (2) enhanced limit order competition, (3) better pricing efficiency and lower volatility, and (4) increased transparency (impact on payment for order flow).

IV. The Debate Over Decimalization

- Common arguments against decimals include liquidity concerns, fear that public investors will be disadvantaged, the absence of any need for change, and high conversion costs. None of these justify refusing to move to decimals.

- Liquidity Concerns: (1) Lower profitability will reduce number of market makers, thereby impeding liquidity, and (2) Narrower spreads will result in smaller quote sizes or "depth."

  - Decimals are likely to result in narrower, more competitive spreads obviously for stocks where the one-eighth spread is artificially constraining, but also for other stocks as well where narrower spreads are not possible (e.g., a stock with a "natural" spread of $.40, which would be permitted with decimals, has to trade with a spread of ½ ($.50) under the current 1/8 system).
  - Reduced costs of trading ultimately should lead to a greater willingness to trade. Canadian exchanges are beginning to see a slight increase in trading volumes.
  - Even if shift has no material effect on spreads, at least stocks will trade more understandably and ongoing software conversion costs imposed on everybody will be saved.
  - If commissions increase while spreads decline, investors still will be better off because commissions are disclosed (and more competitive) while spreads are not.
  - Any drop in market makers will be due to natural competitive forces.
  - Lost market makers are likely to be replaced by more efficient firms post decimals.
  - A decline in "quoted" depth does not necessarily mean a decline in overall depth or in overall market quality.

- Concerns Regarding Treatment of Public Investors: A large minimum increment supposedly deters professional traders from "jumping ahead" of public customer. limit orders.

  - Better priced orders should have priority.
  - Difficult for professionals to engage in "jumping ahead" practice in a dynamic market.
  - Limit order customers have increased their ability to monitor their trading, this is not a real issue.
  - Alternative is to disadvantage all public customers by maintaining artificially wide spreads.
  - Problem presumably would apply to fractions as well as decimals, undercutting proposed moves to sixteenths.
  - If really a concern, SROs or Commission could address issue specifically.

- Conversion Cost Concerns: The costs of converting to decimals are supposedly too high and there is too much going on at the moment to switch.

  - There is always going to be something going on. A few years ago, the move to T+3 supposedly precluded consideration of decimals, now it is the order handling rules and the Year 2000 problem. In a few years we will have T+2 or T+1 , global linkages, foreign ordinaries, expanded hours, or new electronic systems. There will always be something.
  - Issue goes to timing of implementation, not determination of whether to convert. H.R. 1053 allows the Commission to determine an appropriate implementation schedule.
  - Varying stages of readiness by SROs, broker-dealers, vendors, CQS (already decimal ready), CTA (already decimal ready), and ITS.
  - Currencies, commodities, indices, and mutual fund shares are all currently traded or reported in decimals. Thus, most firms currently have decimal capability.
  - Ongoing benefits of conversion would far outweigh one time costs.
  - Costs will always be with us; need to set a reasonable date for implementation.
  - This is the single most important measure we can take to improve the competitiveness of our markets for the benefit of investors.

- The Current System Works Fine.

  - Need to continually improve markets to ensure their ongoing primacy.
  - Need to provide the opportunity for competition to work -- should not have rules and regulations that impede competition or maintain artificially wide spreads across markets.

V. The Issue Has Been Studied for Years

- Outline/reference to numerous previous studies.

- Reference to years' worth of empirical data.

- Reference to previous hearings, etc.

VI. The Experience of the Toronto Stock Exchange in Convertine to Decimals

- Reduction in spreads, little apparent impact on overall market quality, $150 million in savings to investors for trades on 35 most liquid stocks (on volume of less than 1/3 of that of the Dow 30 stocks, and less than 2% of the total volume of our own markets), minimal conversion costs and burdens, and increased share of interlisted stocks.

- TSE experience provides strong support for H.R. 1053.

VII. Conclusion

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Biography

Steven M.H. Wallman

Steven M.H. Wallman was nominated to the Securities and Exchange Commission by President Bill Clinton and confirmed by the Senate on June 19. 1994. He was sworn in as a Commissioner on July 5. 1994. His term expires in June. 1997.

Since arriving at the Commission. Commissioner Wallman has concentrated on a number of issues including capital formation: technology and its implications for capital markets and structure. capital formation and securities regulation; accounting models and financial disclosure, including derivatives and risk disclosure: and international securities regulation.

Prior to being nominated to the Commission. Mr. Wallman was in private practice with the Washington law office of Covington & Burling. He joined the firm in 1975 as an Associate. becoming a Partner in 1986. While at Covington & Burling, Mr. Wallman specialized in general corporate. securities. contract and business law. He is a member of the American Law Institute and the American Bar Association.

Mr. Wallman also worked for the Boston Consulting Group in 1978

Mr. Wallman received his J.D. from the Columbia University School of Law in 1975. In 1976. he earned his Master's degree from the Sloan School of Management at the Massachusetts Institute of Technology and his undergraduate degree from M.I.T. in 1975.

He and his wife live in Great Falls. Virginia.

Mr. Wallman was born on November 14. 1953

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